

MARCH 10, 1986

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# Forbes



## FEELING FOR THE BOTTOM

*Forbes*



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12910378 SZ ZZ 0004  
STATISTICAL REF INDEX  
CONGRESSIONAL INFO SER  
520 EASTWEST HWY  
HESDA MD 20814

March 10, 1986  
Volume 137  
Number 5

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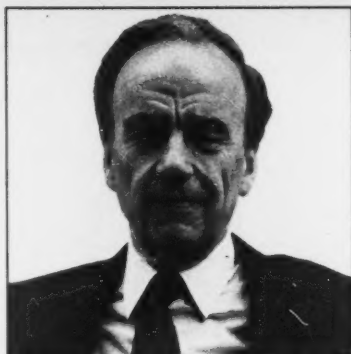
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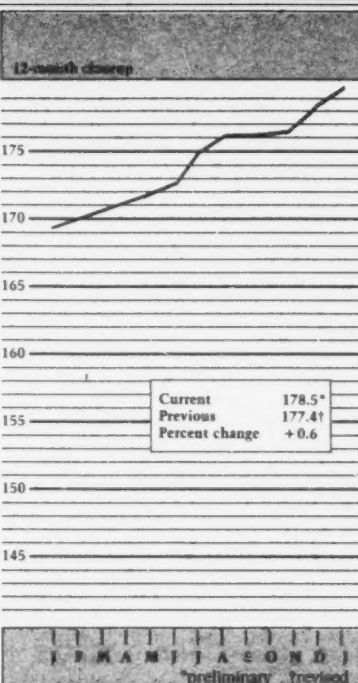
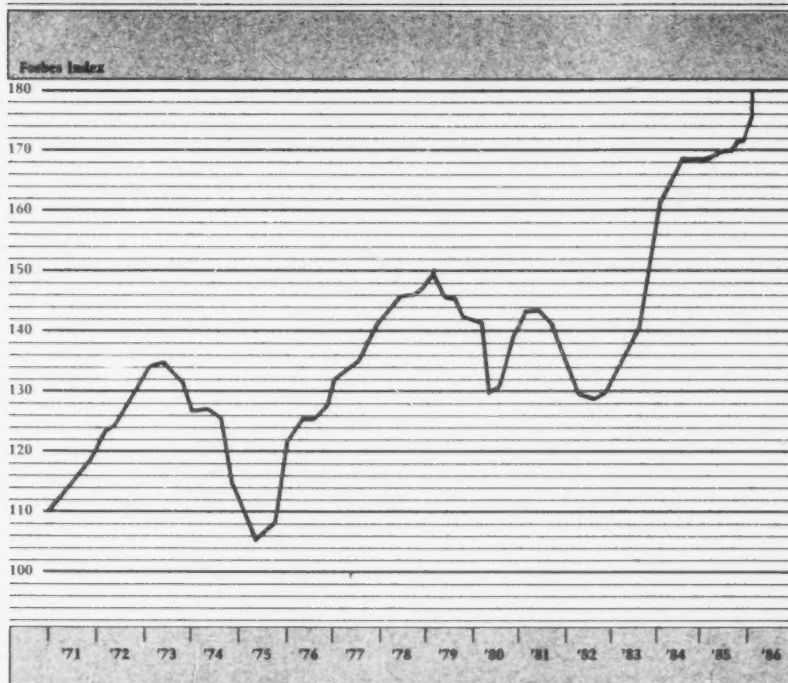
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March 10, 1986 Volume 137 Number 5 Forbes (ISSN 0015 6914) is published biweekly except weekly during two weeks in April, two weeks in September and two weeks in October, by Forbes Inc., 60 Fifth Ave., New York, N.Y. 10011. Second-class postage paid at New York, N.Y., and at additional mailing offices. Subscription \$42 a year, U.S.A. Postmaster: Send address changes to Forbes, 60 Fifth Ave., New York, N.Y. 10011. Copyright © 1986 Forbes Inc. Title is protected through a trademark registration in the U.S. Patent Office.

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Cover illustration by Peter de Sève

# The Forbes Index



**Net, net, no complaints.** Total retail sales merely inched ahead in January—up 0.1%. It was the lamest performance since the component declined 3.9% in October. Were it not for Detroit's financing incentives, which pushed auto sales up 0.9%, overall sales would have been down 0.2%.

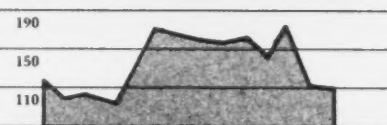
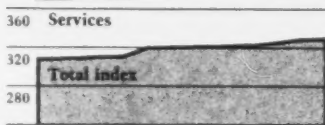
The torrid pace of consumer spending and borrowing in

the past year was clearly unsustainable, but it's not headed for the pits. Both personal income and consumer spending are likely to be boosted by cheaper energy costs, lower interest rates and a 5.3% month-to-month drop in new unemployment claims. In addition, manufacturers' new orders for durable goods went up 4.3%, while inventories were virtually unchanged.

## The Forbes Index Components

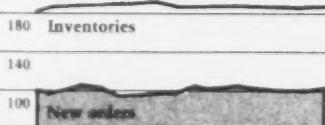
The Forbes Index is a measure of U.S. economic activity composed of eight equally weighted elements: Total industrial production, new claims for unemployment compensation, the cost of services relative to all consumer prices, the level of new orders for durable goods compared with manufacturers' inventories, total retail sales, new housing starts, personal income, total consumer installment credit.

To measure these eight elements, FORBES monitors ten series of U.S. government data. The last 14 months' data for each series are presented at right.



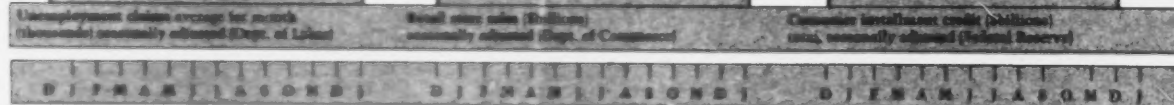
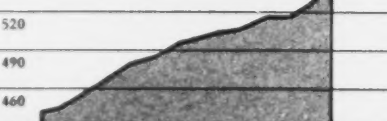
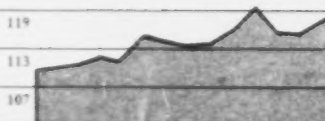
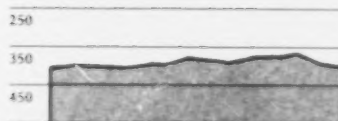
Consumer price indexes (1967 = 100)  
all urban consumers, unadjusted (Dept. of Labor)

New housing starts (thousands)  
privately owned, unadjusted (Dept. of Commerce)



Manufacturers' new orders and inventories  
(billions) seasonally adjusted (Dept. of Commerce)

Personal income (billions) wage and salary disbursements, seasonally adjusted (Dept. of Commerce)



## The worst is yet to come

**W**e're supposed to be the resident cynics, and we've been too optimistic," says Charles Maxwell, a gray-haired analyst at Cyrus J. Lawrence in New York City. Maxwell has been an eloquent pessimist about oil prices since 1980. All last year he was saying oil could go to \$22. He has been more than vindicated. Now listen to him.

Oil, which has dropped 50% on the spot markets since mid-November, will drop even lower. This year Maxwell foresees prices of \$13 a barrel, and perhaps as low as \$8.

Even at \$13 spot prices, earnings and dividends would be off sharply at most big oil companies. How badly off? Maxwell and his colleague, analyst Frederick Leuffer, think some of the highly leveraged oil companies might be hard-pressed to survive.

"At \$20 a barrel, a lot of damage is done to earnings," says Leuffer, who is gloomier than other analysts (see story). Chevron's earnings would be \$3, down 29% from last year. At historical price/earnings multiples, Leuffer would expect Chevron to sell in the low- to mid-20s, but the stock was recently 35%. Texaco's earnings would fall to 80 cents a share, he predicts.

At \$15? "Only Exxon, Imperial, Royal Dutch/Shell, Kerr-McGee and Sohio [would] earn their dividends," Leuffer states in a recent report. Some oil giants—Mobil, Texaco, Amoco, Occidental, Phillips and Unocal—would not even cover their dividends from their free cash flow, which Leuffer defines as operating income before depreciation but after taxes and nondiscretionary spending.

With the vindication of their bearish sentiments, Maxwell and Leuffer have been in demand. A morning interview with them is interrupted by a breathless colleague who has heard that Iranian troops are infiltrating the swamps near the Kuwaiti border. Maxwell responds crisply that the Iranians can't get their weapons through the swamps and returns to his gloomy oil-stock analysis.

Oil prices will keep falling because, in the short run, demand for oil is inelastic. You don't redesign chemical plants and tear out attic insulation when oil prices fall.

The noncommunist nations now consume some 45.5 million barrels of oil a day, 2 million or 3 million barrels less than production. That's not a huge surplus, but since prices are set at the margin, it is enough to play hell with prices. Maxwell figures that if free market forces prevail, spot prices could drop as low as \$6 to \$10 a barrel. "It takes that low a price to shut off oil [production] and increase demand to take care of 2 million [surplus] barrels from OPEC," Maxwell says.

Suppose the oil producers get together and say: Enough, let's have orderly cutbacks. Even so, Maxwell sees a decline to \$12 to \$14 a barrel.

The spot price for oil was recently about \$16 a barrel, but large U.S. oil companies are still getting \$22 to \$24. Eventually, Maxwell says, the large refineries' posted prices will descend toward the spot prices.

"If [spot prices] get down to \$12 to \$14, Phillips and Unocal are certainly on our danger list," Leuffer says. (Thank you, Boone Pickens.)—Robert McGough

### Dividend cuts ahead?

If oil goes to \$15 and stays there, dividends of some big formerly blue chips are in trouble. Average refinery prices are currently higher but, in light of what's happening in the spot market, endangered.

| Company                            | 1985 EPS <sup>1</sup> | Indicated dividend rate | Estimated 1986 EPS<br>—based on oil price of— |          |
|------------------------------------|-----------------------|-------------------------|-----------------------------------------------|----------|
|                                    |                       |                         | \$20/bbl                                      | \$15/bbl |
| Amerada Hess                       | \$2.04                | \$1.10                  | \$1.50                                        | \$0.50   |
| Amoco                              | 7.42                  | 3.30                    | 5.50                                          | 2.75     |
| Atlantic Richfield                 | 6.90                  | 4.00                    | 6.00                                          | 3.00     |
| Chevron                            | 3.85                  | 2.40                    | 3.00                                          | 0.80     |
| Exxon                              | 6.46                  | 3.60                    | 5.50                                          | 3.60     |
| Imperial Oil <sup>2</sup>          | 3.04                  | 1.19                    | 3.53                                          | 2.66     |
| Kerr-McGee                         | 2.62                  | 1.10                    | 1.80                                          | 1.10     |
| Mobil                              | 3.79                  | 2.20                    | 2.20                                          | 1.00     |
| Occidental Petroleum               | 2.20                  | 2.50                    | 1.80                                          | 0.00     |
| Phillips Petroleum                 | 1.59                  | 1.00                    | 0.00                                          | -1.07    |
| Royal Dutch Petroleum <sup>2</sup> | 11.50 <sup>3</sup>    | 3.29                    | 10.00                                         | 7.80     |
| Shell Transport <sup>2</sup>       | 6.80 <sup>3</sup>     | 2.52                    | 5.80                                          | 4.50     |
| Standard Oil (Ohio)                | 6.21                  | 2.80                    | 5.00                                          | 2.75     |
| Sun Co                             | 4.71                  | 3.00                    | 4.10                                          | 2.40     |
| Texaco                             | 4.40                  | 3.00                    | 0.80                                          | -3.00    |
| Unocal <sup>4</sup>                | 3.48                  | 1.20                    | 1.60                                          | -0.40    |

<sup>1</sup>Before nonrecurring items. <sup>2</sup>In U.S. dollars. <sup>3</sup>Estimate. <sup>4</sup>Includes Union Exploration Partners, Ltd.

Sources: Fred Leuffer, Cyrus J. Lawrence Inc.; Standard & Poor's; Value Line.

year's end.

The action upstream is calmer. Last November Keller sold Gulf's 60% stake in Gulf Canada Ltd. to Toronto-based Olympia & York, Ltd. That eliminated a lot of pressure. "Once we got \$2.1 billion from Gulf Canada," Keller says, "any chance of having to have a fire sale was gone." Chevron is now looking hard at thousands of so-

called stripper wells, those that produce five barrels of oil a day or less. Keller: "We're trying to package groups of [stripper well] assets that would have a higher value to a local operator who could then run them differently."

Gulf's paramount attraction to Keller, he says, was its oil and gas reserves. While Chevron had one of the

best exploration records in the business, 34% of its production (excluding oil it got from Saudi Arabia from its Aramco participation) was outside the U.S. Its cost to find and develop reserves has been running at \$10 to \$15 a barrel. Acquiring Gulf more than doubled Chevron's proven reserves (to 1.97 billion barrels of oil and 8.65 trillion cubic feet of natural

*The new-issues market picked up smartly last year, and 1986 could be its hottest year ever—surpassing even 1983.*

## Here we go again

By Richard L. Stern  
and Paul Bornstein

**A**S THINGS ARE shaping up, 1986 could be the biggest year for new issues in history, surpassing even the wild markets of the late 1960s and 1982-83. With market indicators hitting new highs, the investment bankers are sensing an increasingly voracious public appetite for new issues. Indeed, three brokerage houses themselves are going public: Alex. Brown & Sons, Morgan Stanley and L.F. Rothschild. In January alone some 102 companies filed to go public, compared with just 47 firms in January 1985.

Fodder for the high rollers? Of the 102, 31 were blind pools, companies that first take the money and then decide what to do with it. But the pacesetter for the new boom may be Microsoft, a computer software company that is being talked up on The

Street much the same way Apple Computer was when it came public in late 1980.

The seeds for a frenetic new-issues cycle this year were sown quietly and with little notice last year. In terms of money raised, 1985 was the second-biggest year ever for initial public stock offerings, according to FORBES' survey of initial public offerings (IPOs). Last year 494 companies offered their stock to the public for the first time and raised \$8 billion. This fell well short of the 863 companies that raised \$12.6 billion in the wild 1983 record year, but it was a smart gain over 1984's 526 issues, raising \$3.6 billion.

And that sort of gain generates a momentum that can launch a new-issue frenzy. Some 56% of last year's 494 issues were up over their offering price as of Feb. 6, and even more important, 50% outperformed the S&P's 500 over that period.

Which is generally the stuff of hot new-issues cycles that then develop along predictable lines. Fanned by a burst of short-term gains, greedy investors pour into the markets. Delighted brokers feed the demand by foisting increasingly speculative issues on the public.

For individual investors, this is a cautionary tale, but it's a good deal for everyone else. The newly public companies get a nice chunk of fresh cash, and the brokers and investment bankers clean up on fees, commissions and trading profits. In the end the cycle collapses and the investing public discovers its briefly high-flying short-term holdings have turned into long-term losers.

How do we know this? In Decem-

### Biggest IPO underwriters

These investment bankers raised the most equity money in 1985. For each issue, the three lead managers were each credited for the total.

| Rank | Underwriters              | Money raised (\$mil) |
|------|---------------------------|----------------------|
| 1    | Shearson Lehman Brothers  | \$2,274              |
| 2    | Merrill Lynch             | 2,273                |
| 3    | Goldman Sachs & Co        | 1,718                |
| 4    | Salomon Brothers          | 1,384                |
| 5    | First Boston Corp         | 954                  |
| 6    | Kidder Peabody & Co       | 695                  |
| 7    | EF Hutton                 | 568                  |
| 8    | Smith Barney Harris Upham | 527                  |
| 9    | Paine Webber              | 487                  |
| 10   | Bear Stearns & Co         | 468                  |

### Top 1985 new issues

Below are the 36 best and the 10 worst performing new issues over \$1. Price/earnings ratios were calculated

only for companies with 12 months of earnings. A negative P/E means the company lost money.

| Company                     | Date of offering | % performance—<br>relative to |           | Offer price* | P/E at offering | Current price | Underwriters           |
|-----------------------------|------------------|-------------------------------|-----------|--------------|-----------------|---------------|------------------------|
|                             |                  | actual                        | S&P's 500 |              |                 |               |                        |
| Entertainment Marketing     | 7/10/85          | 281%                          | 236%      | \$2.00       | 40              | \$ 7.63       | Comiteau Levine & Co   |
| Control Resource Industries | 8/ 1/85          | 230                           | 191       | 5.00         | 24              | 16.50         | Steinberg & Lyman      |
| Insituform Group            | 4/16/85          | 227                           | 169       | 4.20         | 12              | 13.75         | Rooney Pace Inc        |
| GridComm                    | 7/18/85          | 213                           | 178       | 6.00         | Neg             | 18.75         | Gilford Securities     |
| Enclision Disposal System   | 6/13/85          | 210                           | 162       | 1.25         | NA              | 3.88          | MHI Meyerson & Co      |
| Instructvision              | 8/27/85          | 200                           | 162       | 1.50         | NA              | 4.50          | Denton & Co            |
| Color Systems Technology    | 8/ 1/85          | 173                           | 140       | 5.00         | Neg             | 13.63         | Whale Securities       |
| Imax Research               | 4/18/85          | 153                           | 107       | 5.00         | Neg             | 12.63         | Rosenkranz Lyon & Ross |

\*Per share. NA: Not available. Neg: Negative.

Sources: FORBES; Securities Data Co.; Institute for Econometric Research.

ber we unveiled FORBES' IPO survey (FORBES, Dec. 2, 1985), tracing the performance of 2,800 new interstate stock offerings from January 1975 through June 1985. We also ranked the overall performance of the investment bankers who brought them public. FORBES' conclusion is that new issues are great moneymakers for investment bankers, but, in general,

poor long-term investments for the public.

Since then, with the help of the Institute for Econometric Research in Fort Lauderdale, Fla. and Securities Data Co. of New York City, we've updated the database through 1985. It now contains some 3,100 public companies, and we've traced their performance through Feb. 6, 1986. We've

also included price/earnings ratios of the IPOs when they went public, and segmented the offerings by industry categories.

Here are some of our findings:

● Shearson Lehman Brothers raised more money than anyone else in 1985, while number two Merrill Lynch missed tying for first place by a scant \$1 million (see table p. 122). Shearson last

### Top 1985 new issues

| Company                 | Date of offering | —% performance—<br>relative to |           | Offer price* | P/E at offering | Current price | Underwriters                                                  |
|-------------------------|------------------|--------------------------------|-----------|--------------|-----------------|---------------|---------------------------------------------------------------|
|                         |                  | actual                         | S&P's 500 |              |                 |               |                                                               |
| PDA Engineering         | 1/18/85          | 152%                           | 93%       | \$7.25       | 23              | \$18.25       | Prudential-Bache<br>LF Rothschild                             |
| JPM Industries          | 7/ 1/85          | 150                            | 120       | 2.00         | Neg             | \$ 5.00       | Joseph McGivney                                               |
| Consolidated Stores     | 6/20/85          | 141                            | 106       | 7.25†        | 31              | 17.50         | Merrill Lynch<br>Prescott Ball & Turben                       |
| Sbarro                  | 5/ 8/85          | 140                            | 97        | 10.37        | 14              | 24.88         | Prudential-Bache                                              |
| Emsec                   | 6/27/85          | 131                            | 102       | 6.50         | 59              | 15.00         | Ladenburg Thalmann & Co.                                      |
| Beebas Creations        | 9/18/85          | 126                            | 89        | 8.25         | 15              | 18.63         | Ladenburg Thalmann & Co.                                      |
| New World Pictures      | 10/25/85         | 125                            | 95        | 7.50         | 94              | 16.88         | LF Rothschild                                                 |
| Autodesk                | 6/28/85          | 125                            | 97        | 11.00        | 24              | 24.75         | LF Rothschild<br>Alex Brown & Sons                            |
| Centrafarm Group        | 1/14/85          | 124                            | 71        | 6.75         | 17              | 15.13         | LF Rothschild                                                 |
| To-Fitness              | 6/28/85          | 120                            | 93        | 5.00         | NA              | 11.00         | Meridian Securities                                           |
| Chemclear               | 10/10/85         | 119                            | 85        | 8.00         | 35              | 17.50         | DH Blair & Co.                                                |
| Union Federal S&L       | 2/14/85          | 113                            | 75        | 8.75         | 7               | 18.63         | EF Hutton<br>Shearson Lehman Brothers                         |
| HE Ventures             | 8/16/85          | 113                            | 82        | 2.00         | NA              | 4.25          | Yves Hentic                                                   |
| TSO Financial           | 10/21/85         | 112                            | 84        | 7.25         | 13              | 15.38         | Kidder Peabody & Co.                                          |
| Anitec Image Technology | 5/23/85          | 109                            | 78        | 11.00        | 9               | 23.00         | Smith Barney Harris Upham<br>Donaldson Lufkin & Jenrette      |
| Circadian               | 6/ 6/85          | 108                            | 81        | 6.00         | 46              | 12.50         | Hauvrecht & Quist                                             |
| Crossland Savings       | 10/23/85         | 107                            | 81        | 9.00         | 2               | 18.63         | Salomon Brothers<br>Smith Barney Harris Upham<br>Paine Webber |
| Health Images           | 7/30/85          | 106                            | 80        | 2.00         | 67              | 4.13          | Spectrum Securities                                           |
| Praxis Pharmaceuticals  | 1/17/85          | 104                            | 56        | 1.50         | NA              | 3.06          | Muller & Co<br>Gaines Berland                                 |
| Reebok Intl             | 7/26/85          | 100                            | 76        | 17.00        | 14              | 34.00         | Kidder Peabody & Co<br>Merrill Lynch                          |
| Spectra Pharmaceutical  | 12/ 5/85         | 100                            | 90        | 2.00         | NA              | 4.00          | Chapin Davis & Co.                                            |
| LBI Lighting Systems    | 3/12/85          | 100                            | 62        | 12.50        | 12              | 16.63         | Drexel Burnham Lambert<br>Ladenburg Thalmann & Co.            |
| Binghamton Savings Bank | 9/19/85          | 99                             | 68        | 8.75         | Neg             | 17.38         | Alex Brown & Sons<br>First Albany Corp.                       |
| Amer City Bus Journals  | 7/18/85          | 95                             | 74        | 10.50        | 53              | 20.50         | Blunt Ellis & Loewi<br>George K Baum                          |
| Braintree Savings Bank  | 6/13/85          | 86                             | 57        | 10.50        | 4               | 19.50         | Moseley Hallgarten Estabrook                                  |
| Western Fed Sav Bank    | 2/14/85          | 84                             | 51        | 8.00         | 3               | 14.75         | Drexel Burnham Lambert                                        |
| Central Sprinkler       | 5/16/85          | 84                             | 56        | 12.75        | 14              | 23.50         | William Blair & Co.                                           |
| Mutual Home Fed Sav     | 1/27/85          | 83                             | 45        | 6.50         | NA              | 11.88         | Self                                                          |

\*Per share. †Adjusted for 2-for-1 split. NA: Not available. Neg: Negative.

Sources: FORBES; Securities Data Co.; Institute for Econometric Research.

year was a top manager for 16 issues that raised \$2.274 billion, and Merrill was a lead honcho for 33 issues that pulled \$2.273 billion.

• While 1985 was certainly a stroug IPO year, it did not bring out the large crop of overblown, superspeculative issues that surfaced, say, in a high-volume boom market like 1982-83 (FORBES, Aug. 1, 1983). In fact, a single

Patrick McDonnell

pair of monster offerings, the largest ever—an \$824 million issue by Firemen's Fund and Rockefeller Center Properties' \$750 million issue—accounted for 19% of the \$8 billion raised.

• By industry category, the most new issues, 45, came from savings and banking institutions, which brought in \$810 million, another 10% of the

year's total.

• Last year saw the vigorous rebirth of real estate investment trusts, the industry group that raised the most money. Nineteen REITs, including Rockefeller Center Properties, raised \$2 billion. But the results for investors in these top categories were quite different. The savings and banking institutions were up 49%, outperform-



### The worst performers over \$1

| Company                    | Date of offering | —% performance—<br>relative to |           | Offer price* | P/E at offering | Current price | Underwriters                                    |
|----------------------------|------------------|--------------------------------|-----------|--------------|-----------------|---------------|-------------------------------------------------|
|                            |                  | actual                         | S&P's 500 |              |                 |               |                                                 |
| Cellufone                  | 2/ 7/85          | -78%                           | -82%      | \$5.00       | Neg             | \$1.13        | Muller & Co                                     |
| Marcom Telecommunications  | 5/29/85          | -76                            | -80       | 3.13         | 20              | 0.75          | Shoenberg Hieber Inc                            |
| Cardinal Entertainment     | 3/ 8/85          | -75                            | -80       | 2.00         | Neg             | 0.50          | SD Cohn & Co                                    |
| CS Television              | 4/30/85          | -73                            | -78       | 2.50         | NA              | 0.69          | First Eastern                                   |
| Donny Osmond Entertainment | 1/16/85          | -73                            | -79       | 5.00         | NA              | 1.38          | EJ Pittock & Co<br>First Securities of Columbus |
| Quantum Diagnostics        | 7/18/85          | -71                            | -74       | 3.00         | Neg             | 0.88          | Broadchild Securities                           |
| Emery Datagraphics         | 4/24/85          | -71                            | -76       | 1.06         | Neg             | 0.31          | EJ Pittock & Co                                 |
| Video Science Technology   | 3/ 1 /85         | -69                            | -74       | 2.00         | Neg             | 0.63          | JF Hoffman Securities                           |
| La Delite                  | 8/ 7/85          | -69                            | -77       | 7.50         | NA              | 2.00          | Patten Securities                               |
| R2 Corp                    | 4/18/85          | -66                            | -71       | 2.00         | Neg             | 0.69          | First Florida Securities                        |

\*Per share. NA: Not available. Neg: Negative.

Sources: FORBES; Securities Data Co.; Institute for Econometric Research.

### Top ten pennies

These are the best performing issues of \$1 and under of the 142 penny stocks brought public in 1985. No avail-

able P/E means no 12-month earnings. Negative P/E means the company lost money.

| Company            | Date of offering | —% performance—<br>relative to |           | Offer price* | P/E at offering | Current price | Underwriters            |
|--------------------|------------------|--------------------------------|-----------|--------------|-----------------|---------------|-------------------------|
|                    |                  | actual                         | S&P's 500 |              |                 |               |                         |
| Metcom             | 3/21/85          | 3,500%                         | 2,841%    | \$0.01       | NA              | \$0.36        | Western Capital         |
| Metro Funding      | 6/12/85          | 1,150                          | 979       | 0.05         | NA              | 0.63          | Self                    |
| Asian Equities     | 4/26/85          | 900                            | 733       | 0.01†        | NA              | 0.10          | First Philadelphia Corp |
| Sintech            | 2/ 5/85          | 550                            | 428       | 1.00         | NA              | 6.50          | Friedman Manger & Co    |
| Inter Venture      | 3/29/85          | 525                            | 415       | 0.10         | NA              | 0.63          | Self                    |
| Best Buy Drugs     | 8/ 1/85          | 350                            | 300       | 0.10         | 100             | 0.45          | J Brooks Securities     |
| Judicate           | 3/21/85          | 300                            | 224       | 1.00         | Neg             | 4.00          | MH Meyerson & Co        |
| American Foodworks | 3/ 7/85          | 300                            | 226       | 0.01         | NA              | 0.04          | J Brooks Securities     |
| Catalina Capital   | 9/ 6/85          | 300                            | 250       | 0.02         | NA              | 0.08          | Alpine Securities       |
| Raxmo Industries   | 8/16/85          | 300                            | 245       | 0.02         | NA              | 0.08          | Alpine Securities       |

\*Per share. †Trading as a unit. NA: Not available. Neg: Negative.

Sources: FORBES; Securities Data Co.; Institute for Econometric Research.

ing the S&P's 500 by 36% by year's end. But 15 of the 19 REITs were down, a cold bath for investors who bought their broker's spiel that these were a safe investment that would yield 7% or more.

• While there were plenty of rotten new issues around last year (about 40%, remember, were down from their offering price), there was not as

much fluff, in terms of inflated P/Es, as in some years past. First of all, only 208 of the 494 that came out in 1985 had 12-month earnings and thus P/Es that were calculable (106 had negative earnings and the rest no 12-month numbers). Second, the average P/E turned out to be a relatively low 25 compared, say, with an average 45 for the 434 companies with earnings in

1983. Last year, in fact, marked the lowest average P/E ratio for IPOs since 1978's average of 14, when there was just a dribble of public interest in new issues (only 68 came to market).

• Although the P/Es were not out of line, there were other signs of an emerging speculative fever in 1985. Along with REITs, the penny stock market was born again. It had all but died after August 1983, when the new-issues market collapsed. One hundred forty-two IPOs with prices of \$1 or less went public in 1985, and they were definitely not for conservative investors. As the table on page 125 shows, only one of the top ten penny performers, Best Buy Drugs, a Florida retail chain with 11 stores, even had a P/E, and that was 100 times earnings.

There also was stepped-up activity at some of the hot new-issues firms whose records show them to be long on hype and short on substance. (To measure consistency and performance quality, FORBES looked at the percentage of an investment banker's new issues that managed to outperform the Standard & Poor's 500.) Some of the poorest long-term performers by this measure showed a burst of activity again last year. Significantly, the top-performing new-issuer for 1985 was Rooney Pace (see table, left). But while six out of seven of Rooney Pace's 1985 new issues outperformed the S&P's, the firm's long-term performance is dismal. Only 14% of its new issues through 1984 have outperformed the S&P's.

The ten top-performing new issues for 1985 also demonstrated the public's growing appetite for the speculative (see table, p. 122). Four of the issues—Sonex Research, a combustion engine research firm with granted and pending patents on its technology; GridComm, which is developing new data transmission technology; J.P.M. Industries, an aspiring financial services company; and Color Systems, a company that converts black-and-white movies to color—were losing money when they went public.

Two others—Radiation Disposal System, a developer of waste disposal technology, and Instructivision, an education software developer—did not have a history of earnings from which to calculate a P/E.

The number one performer, Entertainment Marketing, which distributes consumer electronics products such as stereos and televisions, most recently had a P/E of 38.

So here we go again. The public is off to the races and will end up taken to the cleaners. ■

## The year's best performances

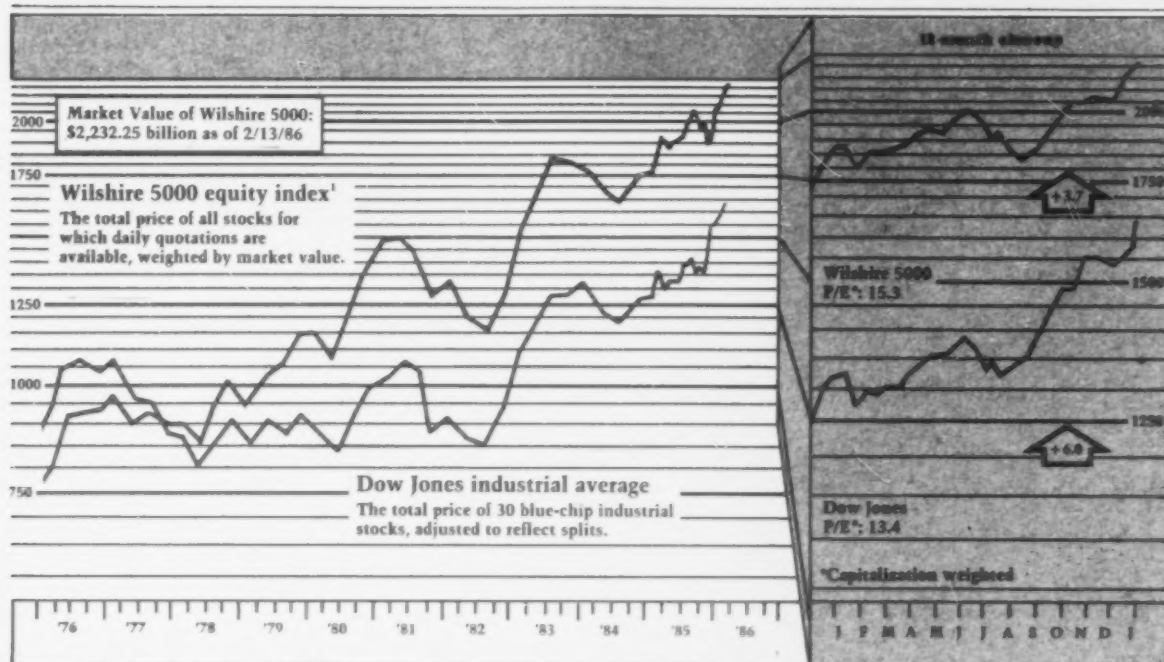
Investment bankers with five or more issues are ranked by the percentage of their IPOs that outperformed the S&P's 500. Ties were broken by the percentage of issues with actual gains. "Long term" is the percentage of issues from 1975 through 1984 outperforming the S&P's.

| Rank | Underwriters           | Number of issues | —% performance—<br>relative to S&P's 500 |           | —% of issues with gains—<br>relative to S&P's 500 |           |
|------|------------------------|------------------|------------------------------------------|-----------|---------------------------------------------------|-----------|
|      |                        |                  | actual                                   | Long term | actual                                            | Long term |
| 1    | Rooney Pace Inc        | 7                | 61%                                      | 36%       | 14%                                               | 100%      |
| 2    | Drexel Burnham         | 18               | 34                                       | 18        | 50                                                | 94        |
| 3    | Morgan Stanley & Co    | 6                | 29                                       | 12        | 40                                                | 83        |
| 4    | Ladenburg Thalmann     | 9                | 48                                       | 29        | 21                                                | 88        |
| 5    | Alex Brown & Sons      | 7                | 42                                       | 21        | 30                                                | 100       |
| 6    | Stuart James           | 7                | 68                                       | 44        | 50                                                | 85        |
| 7    | LF Rothschild          | 7                | 78                                       | 46        | 21                                                | 71        |
| 8    | William Blair & Co     | 7                | 23                                       | 6         | 63                                                | 71        |
| 9    | Moseley Hallgarten     | 6                | 44                                       | 29        | 27                                                | 83        |
| 10   | EF Hutton              | 12               | 38                                       | 19        | 45                                                | 75        |
| 11   | Salomon Brothers       | 8                | 35                                       | 17        | 60                                                | 75        |
| 12   | Merrill Lynch          | 33               | 30                                       | 23        | 39                                                | 75        |
| 13   | J Brooks Securities    | 5                | 138                                      | 101       | 50                                                | 60        |
| 14   | Steinberg & Lyman      | 5                | 77                                       | 55        | NA                                                | 60        |
| 15   | First Albany Corp      | 5                | 27                                       | 15        | 20                                                | 60        |
| 16   | Hambrecht & Quist      | 7                | 32                                       | 14        | 26                                                | 57        |
| 17   | Shearson Lehman Bros   | 16               | 22                                       | 6         | 50                                                | 62        |
| 18   | Dean Witter Reynolds   | 9                | 12                                       | -2        | 42                                                | 77        |
| 19   | Donaldson Lufkin       | 9                | 24                                       | 9         | 35                                                | 66        |
| 20   | Bear Stearns & Co      | 11               | 19                                       | 7         | 39                                                | 63        |
| 21   | Paine Webber           | 11               | 31                                       | 13        | 43                                                | 63        |
| 22   | Smith Barney           | 13               | 29                                       | 31        | 30                                                | 69        |
| 23   | First Boston Corp      | 10               | 18                                       | 27        | 42                                                | 70        |
| 24   | Advest Inc             | 8                | 14                                       | 2         | 40                                                | 62        |
| 25   | DH Blair & Co          | 15               | 8                                        | -6        | 35                                                | 60        |
| 26   | Prudential-Bache       | 11               | 24                                       | 4         | 32                                                | 45        |
| 27   | Patten Securities      | 7                | 15                                       | -2        | 28                                                | 57        |
| 28   | Blum, Ellis & Loewi    | 5                | 23                                       | 11        | 50                                                | 40        |
| 29   | Lazard Frères          | 8                | 16                                       | 2         | 66                                                | 75        |
| 30   | Goldman Sachs & Co     | 14               | 9                                        | -4        | 42                                                | 42        |
| 31   | Blinder Robinson       | 6                | 27                                       | 8         | 10                                                | 83        |
| 32   | Wheat First Securities | 6                | 21                                       | 3         | 50                                                | 50        |
| 33   | Kidder Peabody & Co    | 14               | 10                                       | -2        | 30                                                | 42        |
| 34   | SD Cohn & Co           | 5                | -3                                       | -19       | 40                                                | 20        |
| 35   | Vanderbilt Securities  | 6                | 20                                       | 3         | NA                                                | 50        |
| 36   | Dillon Securities      | 5                | -43                                      | -50       | 25                                                | 20        |

NA: Not available.

# The Forbes/Wilshire 5000 Review

Edited by Steve Kichen



Where the action isn't... and is. Not all share prices are going through the roof. Even as the Wilshire index of more than 5,500 issues set records almost daily, 120 NYSE and 67 Amex stocks fell to new lows. Lists of the worst-performing stocks on each exchange are dominated by oil shares. The Amex market composite index, where oils contribute some 22.9% of overall capitalization, shows a 0.6% decline in 1986, vs. a 3.7% rise in the Wilshire.

But the bad news in the Amex composite obscures better news in some of its components. Half of the eight major stock groups monitored by the American Stock Exchange significantly outperformed the Wilshire. The Amex service group rose 6.8%, capital goods issues gained 6.6% and finance stocks increased 5.9%. It was a 16.6% decline in the natural resource group (largely energy issues) that devastated the Amex composite.

## Closeup On The Equity Markets

### Performance of six leading indexes

| Percent change   | Wilshire 5000 | Forbes 500 <sup>1</sup> | Dow Jones Industrials | NYSE Composite | Amex Market Value Index | NASDAQ Composite |
|------------------|---------------|-------------------------|-----------------------|----------------|-------------------------|------------------|
| in last 4 weeks  | 4.1           | 4.3                     | 6.7                   | 4.8            | -1.5                    | 5.4              |
| in last 52 weeks | 19.1          | 22.4                    | 27.7                  | 18.4           | 5.4                     | 20.6             |

### Stock performance based on six key investor yardsticks

| Percent change   | Company size |       | Volatility <sup>1</sup> |      | P/E multiple |         | Dividend yield |      | Growth profile <sup>4</sup> |      | Share price |           |
|------------------|--------------|-------|-------------------------|------|--------------|---------|----------------|------|-----------------------------|------|-------------|-----------|
|                  | large        | small | high                    | low  | over 25      | under 5 | over 7.5%      | none | high                        | low  | over \$40   | under \$4 |
| in last 4 weeks  | 4.3          | 4.4   | 4.8                     | 3.3  | 3.9          | 4.7     | 2.2            | 2.9  | 2.7                         | 5.9  | 6.1         | 0.9       |
| in last 52 weeks | 22.2         | 22.5  | 33.5                    | 27.7 | 15.1         | 27.5    | 21.3           | 26.4 | 34.3                        | 30.2 | 33.2        | 0.0       |

<sup>1</sup>Wilshire index reflects price performance. It differs slightly from market value of outstanding stocks because of retirements of equity since index was created.

<sup>2</sup>Based on sales.

<sup>3</sup>A stock's sensitivity to overall market movement. High-volatility issues have wide price fluctuations, low-volatility issues are more stable.

<sup>4</sup>A quantitative evaluation of a stock's growth image, determined by Wilshire Associates.

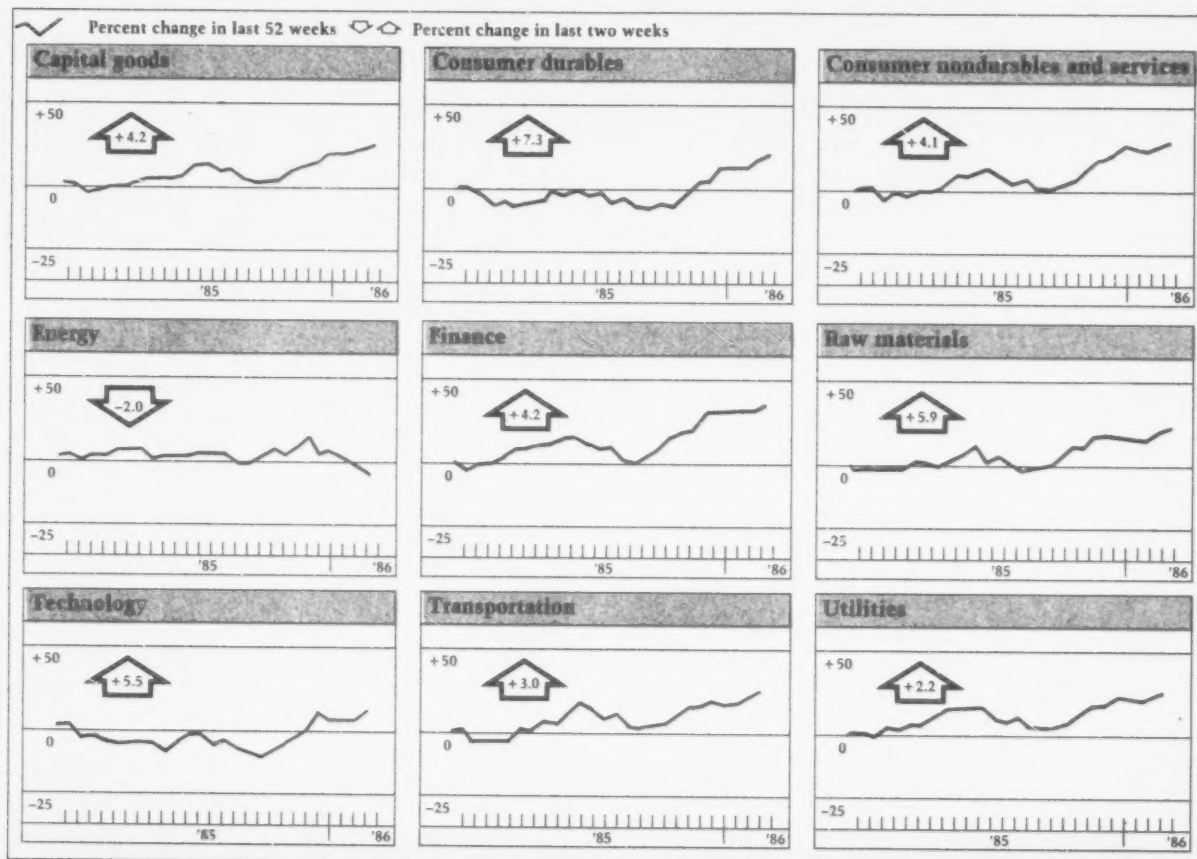
Note: All data for periods ending 2/13/86. Prepared by Wilshire Associates, Santa Monica, Calif.

## Where The Action Is

**Traffic patterns.** The same falling crude oil prices that pushed oil stocks down—the oil sector fell 9.1% over the last four weeks—have given auto stocks a lift. With Chrysler, Ford and General Motors among the best-performing consumer durables shares, the auto sector shows a two-week gain of 7.3%, a four-week gain of 11.6%.

Investors think that cheaper oil will boost sales of

larger—higher-margined—domestic models, but other problems lie ahead. Inventories have grown, sales momentum has weakened, cheap new imports are coming into the market, and Japanese manufacturers are building U.S. assembly plants. Security analysts expect lower earnings in 1987 for domestic manufacturers. Don't be surprised if auto stocks run out of gas.



## What The Analysts Think

**Positive second thoughts.** Analysts' earnings forecasts tend to be overly optimistic the first time around, only to be scaled back later. Over the last two weeks, however,

the analysts had surprising second thoughts in two cases. They raised their 1986 earnings estimates for both consumer nondurables and finance.

| Forecasting the Fortune 500 |                            |      |
|-----------------------------|----------------------------|------|
| Performance period          | Average earnings per share | P/E  |
| latest 12 months            | \$3.17                     | 14.1 |
| 1986 estimates              | 4.18                       | 10.7 |
| 1987 estimates              | 5.15                       | 9.3  |

| Rank based on change in estimate | Sector               | Estimated 1986 EPS | P/E  | % change in 1986 estimate in 2 weeks | % change in 1986 estimate in 4 weeks |
|----------------------------------|----------------------|--------------------|------|--------------------------------------|--------------------------------------|
| 1                                | Consumer nondurables | \$2.62             | 13.2 | %2.64                                | %2.51                                |
| 2                                | Finance              | 3.86               | 9.9  | 0.74                                 | 0.66                                 |
| 3                                | Capital goods        | 2.84               | 13.2 | -0.07                                | -0.76                                |
| 4                                | Consumer durables    | 4.37               | 8.8  | -0.10                                | 0.23                                 |
| 5                                | Utilities            | 3.37               | 8.6  | -0.23                                | -0.35                                |
| 6                                | Raw materials        | 2.30               | 13.0 | -0.66                                | -1.04                                |
| 7                                | Technology           | 2.89               | 13.4 | -0.99                                | -1.14                                |
| 8                                | Transportation       | 2.63               | 11.4 | -1.11                                | -3.29                                |
| 9                                | Energy               | 3.44               | 7.7  | -3.09                                | -3.38                                |

Earnings projections are capitalization-weighted consensus estimates from over 2,000 security analysts. Data are compiled and updated continuously by the Institutional Brokers Estimate System (IBES), a service of Lynch, Jones & Ryan, a New York-based brokerage firm.

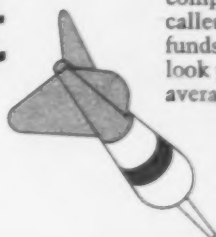
Note: All data for periods ending 2/13/86. Prepared by Wilshire Associates, Santa Monica, Calif.; IBES, a service of Lynch, Jones & Ryan, New York.

Gay French

## Statistical Spotlight

*Our craps shooting computer picked five model portfolios in 1984. Only one did well: low P/E scores again!*

# Not-so-smart dart



By Steve Kichen  
and Michael Ozanian

CAN YOU BEAT the market with a personal computer? FORBES gave this proposition a try in 1984 with five computer-generated portfolios we called Smart Dart and Pure Play funds. Results to date: Four of the five look pretty dumb, trailing the market average by 4 to 41 percentage points.

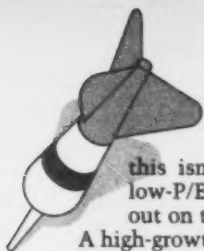
The one that scored was a collection of stocks selling at low price/earnings ratios—that is, cheap.

The small sample size and the brief study period

| Low P/E                                                                                         |                                            |
|-------------------------------------------------------------------------------------------------|--------------------------------------------|
| With a 64% gain since June of 1984, these computer-selected low-P/E stocks made the most money. |                                            |
| Company                                                                                         | Current value of initial \$1,000 positions |
| American Century                                                                                | \$ 687                                     |
| Central Maine Power                                                                             | 1,359                                      |
| Chase Manhattan                                                                                 | 1,804                                      |
| Chemical New York                                                                               | 1,645                                      |
| Cincinnati Gas & Elec                                                                           | 2,022                                      |
| Commonwealth Energy                                                                             | 1,735                                      |
| Consumers Power                                                                                 | 1,775                                      |
| Cont'l Ill Holding (Cont'l Ill)                                                                 | 177                                        |
| Cont'l Illinois right (Cont'l Ill)                                                              | 666                                        |
| DWG                                                                                             | 654                                        |
| El Paso Electric                                                                                | 1,452                                      |
| Finl Corp America                                                                               | 946                                        |
| First Am Finl                                                                                   | 1,360                                      |
| First Western Finl                                                                              | 1,340                                      |
| Ford Motor                                                                                      | 1,776                                      |
| Gibraltar Finl                                                                                  | 1,400                                      |
| Golden West Finl                                                                                | 4,989                                      |
| Kansas Cty Pwr & Lt                                                                             | 1,591                                      |
| Long Island Lighting                                                                            | 2,046                                      |
| Maine Public Svc                                                                                | 1,637                                      |
| Manufacturers Hanover                                                                           | 1,679                                      |
| Middle South Utils                                                                              | 1,090                                      |
| Public Service Indiana                                                                          | 1,043                                      |
| Public Svc New Hamp                                                                             | 1,975                                      |
| Toledo Edison                                                                                   | 1,826                                      |
| United Illuminating                                                                             | 2,304                                      |
| Total value of portfolio                                                                        | \$40,993                                   |

| Growth Fund                                                                                         |                                            |
|-----------------------------------------------------------------------------------------------------|--------------------------------------------|
| These 25 growth stocks are up 37%. Not bad, but not as good as the Wilshire index, which is up 41%. |                                            |
| Company                                                                                             | Current value of initial \$1,000 positions |
| Academy Insur Group                                                                                 | \$ 255                                     |
| Amfesco Inds                                                                                        | 107                                        |
| Avant-Garde Computing                                                                               | 287                                        |
| BR Communications                                                                                   | 537                                        |
| CPI                                                                                                 | 1,284                                      |
| Comair                                                                                              | 2,060                                      |
| Commodore Intl                                                                                      | 199                                        |
| Dryfus                                                                                              | 4,028                                      |
| First Executive                                                                                     | 2,045                                      |
| GTS                                                                                                 | 349                                        |
| General Homes                                                                                       | 942                                        |
| Helen of Troy                                                                                       | 553                                        |
| Jeffrey Martin                                                                                      | 1,076                                      |
| Key Pharmaceuticals                                                                                 | 1,040                                      |
| Limited                                                                                             | 3,881                                      |
| Liz Claiborne                                                                                       | 2,844                                      |
| Nutri/System                                                                                        | 938                                        |
| Phoenix American                                                                                    | 620                                        |
| Provincetown-Boston Air                                                                             | 152                                        |
| Quick & Reilly Group                                                                                | 2,356                                      |
| Southern Hospitality                                                                                | 1,096                                      |
| Xerox (Dysan)                                                                                       | 1,203                                      |
| Yankee Cos                                                                                          | 698                                        |
| Berg Enterprises                                                                                    | reinvested                                 |
| Gulfstream Aerospace                                                                                | reinvested                                 |
| Total                                                                                               | \$28,559                                   |
| Reinvested distributions                                                                            | \$ 5,710                                   |
| Total value of portfolio                                                                            | \$34,270                                   |

| Smart Dart Random Fund                                                                                |                                            |
|-------------------------------------------------------------------------------------------------------|--------------------------------------------|
| Our computer is an unspectacular dart-thrower. In a hot market this random portfolio gained only 30%. |                                            |
| Company                                                                                               | Current value of initial \$1,000 positions |
| Ampad                                                                                                 | \$1,344                                    |
| ARGOSystems                                                                                           | 1,205                                      |
| Bellwether Explor                                                                                     | 338                                        |
| Big Bear                                                                                              | 1,809                                      |
| Burnaby                                                                                               | 796                                        |
| Dreyer's Ice Cream                                                                                    | 1,301                                      |
| AG Edwards                                                                                            | 1,606                                      |
| Forest Labs                                                                                           | 2,000                                      |
| Infodata Systems                                                                                      | 650                                        |
| Intl Banknote                                                                                         | 742                                        |
| Iomega                                                                                                | 2,878                                      |
| Penn Central                                                                                          | 1,163                                      |
| Rainier Bancorp                                                                                       | 1,890                                      |
| Sandwich Chef                                                                                         | 1,033                                      |
| SIS                                                                                                   | 941                                        |
| Seigler Tractor                                                                                       | 609                                        |
| Texas Am Bancshares                                                                                   | 636                                        |
| Time                                                                                                  | 1,438                                      |
| Toro                                                                                                  | 1,711                                      |
| Ultrasonics                                                                                           | 506                                        |
| Victoria Bankshares                                                                                   | 850                                        |
| Winnebago                                                                                             | 1,439                                      |
| American Sterilizer                                                                                   | reinvested                                 |
| Home Centers of Am                                                                                    | reinvested                                 |
| Richardson-Vicks                                                                                      | reinvested                                 |
| Total                                                                                                 | \$26,893                                   |
| Reinvested distributions                                                                              | \$ 5,671                                   |
| Total value of portfolio                                                                              | \$32,564                                   |



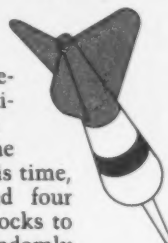
prevent us from drawing any weighty conclusions about investing styles. But this isn't the first time that low-P/E investing has come out on top.

A high-growth, well-managed company is, of course, worth a higher multiple of its earnings than a deteriorating company. But most investors, it seems, have a knack for overdoing this distinction. They overpay for growth companies and sell off the dogs too cheaply. Investors who play the contrary game—that is, buying low-P/E, unglamorous companies—come out ahead. Sometimes.

Our model portfolios are only 20 months old, but the dart board game is a lot older than that. In 1967 three

FORBES executives threw darts at stock market tables, in a tongue-in-cheek test of "random walk" investing. At our final look (July 30, 1984), this list of 28 common stocks beat the Dow by more than 10-to-1, largely on the strength of one extremely lucky pick (Texas Oil & Gas, up 7,000% at that time). After 17 years of mergers and liquidations, the original group had dwindled down to 15 issues and was retired.

The dart board replacement was a microcomputer-selected list of 25 stocks, the Smart Dart Fund. This time, however, we created four other groups of 25 stocks to compete with the randomly



selected group. Each of these portfolios was based on an accepted stock-picking principle.

The Pure Play Price/Earnings Fund consisted of 25 issues with the lowest price/earnings ratios. The Pure Play Book Value Fund contained issues selling at steep discounts to book value. The Pure Play Growth Fund consisted of firms with high sales and earnings growth over the preceding four years. The Pure Play Analysts' Choice Fund was 25 stocks whose anticipated 1985 earnings would show the largest gains over 1983's.

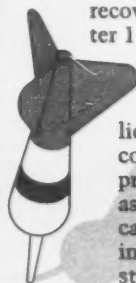
**Current score:** The low-P/E list beat the market handsomely, up 64% vs. 40.6% for the Wilshire 5000 index. The best low-P/E stock was Golden West Financial. This Oakland, Calif.-based bank holding company is up almost 400%.

Now for the losers. In second place was the Growth Fund, which trailed the Wilshire average by a scant 4 points. If the low-P/E theory of investing worked perfectly, the growth stocks—that is, high-P/E stocks—would have come in dead last. But it doesn't work perfectly. As we said, no weighty conclusions. In any event, low-P/E fans can argue that the growth portfolio would have looked pretty dismal were it not for just two companies—that dazzling retailer The Limited and Dreyfus, whose mutual funds are all the rage—and these two may be statistical flukes.

In third place was the Smart Dart Fund, the electronic successor to the original dart board fund. It was 10 points behind the Wilshire index. Three buyouts helped its performance: American Sterilizer, Home Centers of America and Richardson-Vicks. What kept the list down? Ultrasystems, an alternative-energy outfit, has collapsed to half its original value. Bellwether Exploration, Steiger Tractor and Texas American Bancshares also fared poorly.

The Pure Play Book Value Fund pulls up the rear. Sad to say, you can't take a balance sheet at face value. Three companies on this list went bust. Allied Supermarkets, however, a midwestern grocery chain trying to recover from an earlier Chapter 11, is up 162%.

In our initial review (Mar. 11, 1985) of the five new portfolios, we valued acquired companies at the takeover price. This time we have assumed that proceeds of cash tender offers were reinvested in the remaining stocks. ■



### Analysts' Fund

Analysts expected earnings gains in 1985 for these issues. One year later this group remains in fourth place.

| Company                    | Current value of initial \$1,000 positions |
|----------------------------|--------------------------------------------|
| Alcan Aluminium Ltd        | \$1,140                                    |
| Allen Group                | 1,548                                      |
| Allied-Signal (Signal Cos) | 1,821                                      |
| Aluminum Co of Am          | 1,300                                      |
| Arrow Electronics          | 739                                        |
| Black & Decker             | 966                                        |
| Chesapeake                 | 1,218                                      |
| Chrysler                   | 1,906                                      |
| Clark Equipment            | 959                                        |
| Data General               | 878                                        |
| Esterline                  | 710                                        |
| Federal Paper Board        | 1,287                                      |
| Foxboro                    | 855                                        |
| Georgia-Pacific            | 1,469                                      |
| BF Goodrich                | 1,293                                      |
| Joy Mfg                    | 1,016                                      |
| Koppers                    | 1,225                                      |
| Lotus Development          | 1,120                                      |
| Marshall Inds              | 957                                        |
| Mead                       | 1,471                                      |
| Moore McCormack Res        | 1,063                                      |
| Paccar                     | 1,133                                      |
| Singer                     | 1,432                                      |
| St Regis                   | reinvested                                 |
| UTD Energy Res             | reinvested                                 |
| Total                      | \$27,520                                   |
| Reinvested distributions   | \$ 3,564                                   |
| Total value of portfolio   | \$31,083                                   |

### Value Fund

These stocks were all cheap in relation to book value. Alas, more than half just got cheaper.

| Company                          | Current value of initial \$1,000 positions |
|----------------------------------|--------------------------------------------|
| Allied Supermarkets              | \$2,619                                    |
| Barber-Greene                    | 1,500                                      |
| Biotech Capital                  | 1,944                                      |
| Charter Co                       | 1,176                                      |
| Consumers Power                  | 1,775                                      |
| Cont'l Ill Holding (Cont'l Ill)  | 177                                        |
| Cont'l Illinois Ind (Cont'l Ill) | 666                                        |
| Crocker Natl prof (Crocker Natl) | 1,620                                      |
| Crompton                         | 27                                         |
| Digicon                          | 236                                        |
| Evans Products                   | 186                                        |
| General Pub Utils                | 2,161                                      |
| Inspiration Res                  | 791                                        |
| Keystone Consol Inds             | 764                                        |
| LTV (Republic Steel)             | 400                                        |
| LTV \$1.25 cv pref* (Rep St)     | 125                                        |
| Long Island Lighting             | 2,046                                      |
| Manufacturers Hanover            | 1,679                                      |
| Manville                         | 924                                        |
| Marine Midland Banks             | 2,136                                      |
| Offshore Logistics               | 214                                        |
| Peoples Restaurants              | 0                                          |
| Petri-Lewis                      | 264                                        |
| Public Service Indiana           | 1,043                                      |
| Transcontinental Energy          | 13                                         |
| Twin City Berge                  | 142                                        |
| Wheeling-Pittsburgh Steel        | 352                                        |
| Total value of portfolio         | \$24,991                                   |

\*Series D.

## Commodities

MONEY & INVESTMENTS

*Congress has come up with a new piece of farm legislation. Will it prove again that congressmen make lousy farmers?*

# WEEVILS OF A DIFFERENT SORT

By Stanley W. Angrist



The cotton market has been sitting around quietly waiting for the other shoe to drop. "The other shoe" being a price called the "announced loan rate." Last year farmers could put their crop into government storage and receive loans at the rate of 57.3 cents per pound. (In years when a commodity under government loan has a market price less than the loan price, farmers may choose to default on their loans, leaving the government with the commodity.)

Under the new bill, the formula loan rate for cotton has been set at 55 cents, but the Secretary of Agriculture has the right to set the announced loan rate as much as 20% below the formula rate—in this case 44 cents. One of the goals of the new farm bill (1,397 pages, 13 pounds) is to lower U.S. commodity prices so that they are more competitive with world commodity prices. Before recommending a trade based on these circumstances, let's look at the fundamentals that have been driving this market.

The world produces too much cotton. That fact is made plain by the supply/demand table on the right. Even though it is estimated

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that worldwide production will decline from last year's 85.8 million bales to 81.1 million bales, ending stocks will probably rise to 51.1 million bales. That means that cotton on hand will exceed 70% of this year's consumption. That is an awesome figure, dwarfing last year's astounding 57.4%.

In early January the U.S. Department of Agriculture released its fifth cotton production estimate of the 1985-86 season. All cotton was put at 13.4 million bales, a slight decrease from the prior month's forecast of 13.7 million bales. The revision is not the important thing; what is important is that U.S. stocks will be large relative to needs throughout the marketing year.

However, it is interesting to note that prices have not reached the low set in September when the March contract sold for under 59 cents per pound. The movement of cotton into government loan programs, accompanied by better U.S. mill demand, has helped keep prices above those lows. These two factors have helped to support old crop cotton, despite the more than adequate supplies. New crop supplies (contract months from October on) have been much weaker, as well they should be in the face of the prospect of much lower loan rates.

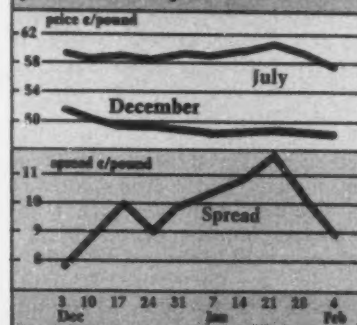
The spread be-

tween July (old crop) and December (new crop) has widened several hundred points since the fall, but I think that it can go further still. It will be driven by the buildup in stocks and the changes coming in the government loan rate. Therefore, I would try to buy July/sell December cotton, with July at no more than a 10-cent premium to December. I think this spread could easily widen 4 cents (\$2,000 per spread) in the next couple of months. The margin on this trade is \$600, while the round-turn commission is about \$50 at a discount broker.

You should be aware that because this spread involves an old crop month and a new crop month, it can be volatile. So if you put this spread on, you must watch it closely. ■

### Cotton capers

The premium that July cotton (old crop) carries to December (new crop) has been unusually volatile. Reason: a growing realization that the new farm bill empowers the Secretary of Agriculture to reduce sharply the loan price for new crop cotton.



Shelley Dell

### Lots of supply, too little demand

The world has been producing too much cotton relative to demand. Part of the problem is that it is produced in a number of developing countries that will try to increase their crops, regardless of the price they get.

| Crop year   | Crop | Usage | Ending stocks | Stocks as a % of usage |
|-------------|------|-------|---------------|------------------------|
| 1977-78     | 63.9 | 59.7  | 26.3          | 44.1%                  |
| 1978-79     | 59.6 | 62.0  | 24.2          | 39.0                   |
| 1979-80     | 65.2 | 65.3  | 23.9          | 36.6                   |
| 1980-81     | 64.8 | 65.9  | 24.1          | 36.6                   |
| 1981-82     | 70.8 | 65.5  | 28.7          | 43.8                   |
| 1982-83     | 67.5 | 67.6  | 29.0          | 42.9                   |
| 1983-84     | 67.4 | 69.2  | 27.2          | 39.3                   |
| 1984-85     | 85.8 | 69.8  | 40.1          | 57.4                   |
| 1985-86 est | 81.4 | 72.1  | 51.3          | 71.2                   |

All numbers are in millions of bales (478 pounds net weight).